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SUBJECT: LUXEMBOURG FENDS OFF EU VAT CHANGES

¶1. (SBU) SUMMARY. At the EU Economic and Finance (Ecofin) Council meeting on June 5, Luxembourg successfully fended off proposed changes to EU value added tax (VAT) policy which would have eroded its competitive advantage regarding VAT rates on e-commerce. Prime Minister Juncker said that the changes could have cost the Grand Duchy 300 million euro or one percent of its GDP per year. Under pressure from its EU partners, however, Luxembourg may ultimately compromise and agree to an extended phase in period for such VAT changes. END SUMMARY.

¶2. (U) At the June 5 meeting of the Ecofin Council, Luxembourg Prime Minister (and Finance Minister) Jean-Claude Juncker took the uncharacteristic step of essentially "vetoing" proposed changes to EU VAT policy which included a provision changing the point of collection for the VAT on online services. These proposals would have changed the VAT to be collected at point of consumption, vice the current arrangement which collects them at the location of the service provider. With the lowest allowable VAT rate in the EU of 15%, this policy benefits Luxembourg over its neighbors Germany (19% VAT), France (19.6%), and Belgium (21%). Accordingly, e-commerce heavyweights such as AOL, iTunes, Skype, and most recently PayPal, have established themselves in Luxembourg as a base for their EU operations. Juncker said that the value of these VAT revenues to Luxembourg is between 220 and 300 million euro per year or one percent of Luxembourg's GDP. Industry experts estimate the potential loss in revenue for Luxembourg to be even higher.

¶3. (SBU) COMMENT. Breaking ranks with its EU partners is highly unusual for Luxembourg. Prime Minister Juncker is famous for his efforts to support a strengthening of EU structures and policies and he is known as a tireless consensus builder. Voting alone against other members of the EU was obviously painful for him. The issue will likely be revisited under the Portuguese EU Presidency, however, and post's sources suggest that under pressure the GOL might ultimately accept an extended phase-in period for any VAT changes regarding e-commerce. END COMMENT
WAGNER